

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



FISCAL MEMORANDUM

HB 1367 – SB 1363

April 4, 2017

SUMMARY OF ORIGINAL BILL: Changes the classification of property of incumbent local exchange telephone companies (ILEC) that elect market regulation pursuant to Tenn. Code Ann. § 65-5-109 and property telephone cooperatives organized pursuant to Tenn. Code Ann. § 65-29-102, from public utility to industrial and commercial property. These changes are effective January 1, 2017. Discontinues the Telecommunications Ad Valorem Tax Reduction Fund effective June 2, 2017.

FISCAL IMPACT OF ORIGINAL BILL:

Decrease State Revenue – \$1,196,900/General Fund
\$2,685,400/Department of Education
\$15,200/Department of Revenue
\$37,900/Sinking Fund

Decrease Local Revenue – Net Impact – \$2,728,300

Other Fiscal Impact – The Telecommunications Ad Valorem Tax Reduction Fund will be discontinued by June 2, 2017. All revenue in the fund will be dispersed to eligible telecommunication service providers; therefore, any remaining balance will be not significant.

SUMMARY OF AMENDMENT (006592): Deletes and rewrites the original bill such that the substantive changes are as follows: adds competitive local exchange telephone companies (CLETC) that elect market regulation pursuant to Tenn. Code Ann. § 65-5-109 to those entities whose property is classified as industrial and commercial property; redistributes the sales and use tax collected from interstate or international telecommunications services sold to businesses; and requires a sum sufficient amount from the state General Fund to be allocated to municipalities and counties if the redistribution is not sufficient to offset the decrease in local revenue resulting from the reclassification of ILEC, CLETC, and cooperative property taxes.

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FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENT:

**Decrease State Revenue - \$1,496,100/General Fund
\$3,356,800/Department of Education
\$18,900/Department of Revenue
\$47,400/Sinking Fund Account**

Increase State Expenditures – \$476,300/General Fund

Decrease Local Revenue – \$237,400/Municipalities

Other Fiscal Impact – The Telecommunications Ad Valorem Tax Reduction Fund will be discontinued by June 2, 2017. All revenue in the fund will be dispersed to eligible telecommunication service providers; therefore, any remaining balance will be not significant.

Assumptions for the bill as amended:

- Pursuant to Article 2, Section 28 of the Tennessee Constitution, public utility real property is assessed at 55 percent of its value and industrial and commercial real property is assessed at 40 percent of its value.
- Pursuant to Tenn. Code Ann. § 65-5-109(a), unused tangible personal property classified as public utility property is assessed at 55 percent of its value and unused tangible personal property classified as industrial and commercial is assessed at 30 percent of its value.
- Based on information provided by the Comptroller of the Treasury (Comptroller), decreasing real and personal property of ILECs, CLETCs and cooperatives from a 55 percent of the assessed value to 40 percent of real property and 30 percent of personal property will result in a weighted decrease in local property tax revenue of 41.8182 percent.
- Based on information provided by the Comptroller, tax year 2016 distribution to local government for ILECs, CLETCs and cooperatives was \$35,664,267. This analysis assumes distributions to local governments are constant in future years.
- Classifying ILEC, CLETCs and cooperative real and personal property as industrial and commercial will result in a recurring decrease in local revenue estimated to be \$14,914,155 ($\$35,664,267 \times 41.8182\%$).

Assumptions Related to Sales and Use Tax:

- Pursuant to Tenn. Code Ann. § 67-6-221(a), interstate or international telecommunication services sold to businesses are subject to a sales and use tax imposed at a rate of 7.5 percent.
- Under current law, pursuant to Tenn. Code Ann. § 67-6-221(b), revenue is distributed in the following weighted percentages for the following purposes:

- 53.33 percent Telecommunications Ad Valorem Tax Reduction Fund
- 6.67 percent educational purposes for kindergarten through grade 12
- 6.67 percent incorporated municipalities and unincorporated areas of counties
- 33.33 percent, or the remaining balance, deposited in the General Fund and allocated as follows pursuant to Tenn. Code Ann. § 67-6-103(a):
 - 29.0141 percent General Fund
 - 65.0970 percent Educational
 - 4.6030 percent Municipalities
 - .3674 percent Department of Revenue
 - .9185 percent Sinking Fund Account
- This legislation discontinues the Ad Valorem Tax Reduction Fund effective June 2, 2017 and reallocates interstate or international telecommunication services 7.5 percent sales and use tax as follows:
 - 6.67 percent educational purposes for kindergarten through grade 12
 - 93.33 percent distributed to municipalities and counties to reimburse for property tax reclassification reductions
- Based on information provided by the Comptroller, the annual sales and use tax revenue collected for interstate or international telecommunication services is \$15,469,717. This analysis assumes this collection will remain constant in future fiscal years.
- Based on information provided by the Comptroller, the Comptroller's Office will disperse all funds in the Telecommunications Ad Valorem Tax Reduction Fund to eligible recipients. The Fund will no longer exist in FY17-18 and subsequent fiscal years.
- The redistribution of sales and use tax revenue will lead to a recurring increase in local revenue estimated to be \$14,437,887 ($\$15,469,717 \times 93.33\%$) for municipalities and counties.
- Under current law, total annual collections of the remaining balance are estimated to be \$5,156,572 ($\$15,469,717 \times 33.33\%$). The provisions of this legislation would eliminate the balance.
- The redistribution of sales and use tax revenue will lead to a recurring decrease in the remaining funds previously deposited in the General Fund and allocated pursuant to Tenn. Code Ann. § 67-6-103(a) as follows:
 - General Fund: \$1,496,133 ($\$5,156,572 \times 29.0141\%$).
 - Educational Purposes: \$3,356,774 ($\$5,156,572 \times 65.0970\%$).
 - Municipalities: \$237,357 ($\$5,156,572 \times 4.6030\%$).
 - Department of Revenue: \$18,945 ($\$5,156,572 \times .3674\%$).
 - Sinking Fund Account: \$47,363 ($\$5,156,572 \times .9185\%$).

Assumptions Related to Reimbursement of Ad Valorem Taxes:

- This legislation requires the state to allocate to local governments a sum sufficient amount from the General Fund to offset any decrease in local revenue resulting from the property tax reclassification of ILECs, CLETCs, and cooperative properties.
- This will lead to a recurring increase in state expenditures from the General Fund estimated to be \$476,268 ($\$14,914,155 - \$14,437,887$); and this will further lead to a net

impact on local government revenue of not significant as it relates to property tax reclassification.

- Local governments will experience a recurring decrease in local revenue estimated to be \$237,357 that was previously earmarked for municipalities as noted above.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

A handwritten signature in blue ink that reads "Krista M. Lee". The signature is written in a cursive, flowing style.

Krista M. Lee, Executive Director

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